IN THE HIGH COURT OF JUDICATURE AT MADRAS

Dated: 06-02-2002

Coram:

The Honourable Mr. Justice V.S. SIRPURKAR
and
The Honourable Mr. Justice K. RAVIRAJA PANDIAN

T.C. No.1030 OF 1988 and T.C. No.165 OF 1989

M/s. RM. Appavu Chettiar Sons
Madurai :: Applicant

:versus:

The Commissioner of Income-tax
Madurai :: Respondent

Tax Case Reference under Sec.256(1) of the Income-tax Act, 1961 by the Income Tax Appellate Tribunal, Madras ôBö Bench in R.A. No.551 (Mds.) of 1987.

: JUDGMENT

V.S. SIRPURKAR, J.

Two questions have been referred by the Income Tax Appellate Tribunal, Madras. They are:
ô1. Whether on the facts and in the circumstances of the case the disallowance of salary payments amounting to Rs.1,92,000/- to the partners of the assessee-firm by invoking section 40(b) of the Income-tax Act, 1961 is right in law?

2. Whether on the facts and in the cirumstances of the case the disallowance of interest payments amounting to Rs.8,412/- to the partners of the assessee-firm in their individual capacity by the assesseepartnership by invoking section 40(b) of the Act is justified in law?ö

At the beginning of his arguments, the learned senior counsel appearing for the assessee categorically stated that he was not arguing the second question. We are, therefore, only concerned with the first question here which relates to the salary payments made to the partners of the assessee firm.

2. One M/s. RM. Appavu Chettiar Sons, Madurai, which

is a partnership firm, is the assessee. In the relevant assessment year 1983-84, the assesseeÆs accounts showed that salary payments were made to the tune of Rs.1,92,000/- to the partners of the assessee firm in their individual capacity by the assessee partnership firm. The assessee had claimed this amount as the allowable expenditure relying on Explanation (2) to Sec.40(b) of the Income Tax Act, 1961 (hereinafter referred to as ôthe Actö). That was disallowed by the Income Tax Officer. In the appeal before the Commissioner (Appeals) also the said disallowance was upheld. The Commissioner (Appeals) followed the decision of the Madras High Court in the case of Dwarakadas Rameshwar Goenka v. Commissioner of Income Tax (127 ITR 397). Therefore, an appeal came to be preferred before the Income Tax Appellate Tribunal. The Tribunal followed their earlier order which they had passed relating to the assessment year 1982-83 as regards the same assessee and held that it was bound by the decision in Dwarakadas Rameshwar GoenkaÆs case, cited supra and the contrary decision of the Andhra Pradesh High Court in NTR Estate v. CIT (157 ITR 285) was not binding. The Tribunal also chose to follow the later decision of the Madras High Court in Venkatesh Emporium v. CIT (137 ITR 593) as also the decision in A.S.K. Rathnaswamy Nadar Firm v. CIT (58 ITR 312). The Tribunal held that the earlier order passed by itself was based on the direct authorities of the two decisions of the Madras High Court, which were binding on the Tribunal, and, therefore, the Tribunal upheld the disallowance of salary payments to the tune of Rs.1,92,000/- as also the interest payment of Rs.8,412/-. Ultimately, the two questions came to be referred, which we have quoted above, out of which, we would be concerned only with the question regarding the salary payment.

3. The learned senior counsel appearing for the assessee very painstakingly chartered the history of Sec.40(b) of the Act as it stood then and more particularly invited our attention to the language of the relevant provision which is as under:

ô40.Amounts not deductible.-
Notwithstanding anything to the contrary in sections 30 to 39, the following amounts shall not be deducted in computing the income chargeable under the head æProfits and gains of business or professionÆ.- ...

(b) in the case of any firm, any payment of interest, salary, bonus, commission or remuneration made by the firm to any partner of the firm;

Explanation 1.- Where interest is paid by a firm to any partner of the firm who has also paid interest to the firm, the amount of interest to be disallowed under this clause shall be limited to the amount by which the payment of interest by the firm to the partner exceeds the payment of interest by the

partner to the firm.

Explanation 2.- Where an individual is a partner in a firm on behalf, or for the benefit, of any other person (such partner and the other person being hereinafter referred to as æpartner in a representative capacityÆ and æperson so representedÆ respectively),-

(i) interest paid by the firm to such individual or by such individual to the firm otherwise than as partner in a representative capacity, shall not be taken into account for the purposes of this clause;
(ii) interest paid by the firm to such individual or by such individual to the firm as partner in a representative capacity and interest paid by the firm to the person so represented or by the person so represented to the firm, shall be taken into account for the purposes of this clause.

Explanation 3. - Where an individual is a partner in a firm otherwise than as partner in a representative capacity, interest paid by the firm to such individual shall not be taken into account for the purposes of this clause, if such interest is received by him on behalf, or for the benefit of any other person.ö

4. The learned counsel drew our attention to the decision of the Apex Court in Brij Mohan Das Laxman Das v. CIT (223 ITR 825) and pointed out that though the above amendment had become effective from 1-4-1985. The Apex Court had specifically held that even for the period anterior to 1st April, 1985, any interest paid to a partner representing his Hindu Undivided Family, on deposit of his personal/ individual funds, does not fall within the mischief of clause (b) of Sec.40. The learned counsel further pointed out that the Apex Court had upheld the view taken by the Rajasthan High Court in Gajanand Poonam Chand And Bros. v. CIT (174 ITR 346) that the explanation in the context of Sec.40(b) is declaratory in nature (and hence operative retrospectively). It is also pointed out by the learned counsel that this decision was later on followed and upheld by the Apex Court in Suwalal Anandilal Jain v. CIT (224 ITR 753). Therefore, according to the learned counsel, the position of law which emerges is that the payment of interest to a partner representing a Hindu Undivided Family is not hit by clause (b) of Sec.40 and does not become disallowable expenditure under that section and secondly, that the said provision is retrospective in nature being declaratory. The learned counsel also explains that though in the subsequent decision in Rashik Lal And Co. v. CIT (229 ITR 458) the Supreme Court expressed that the amendment was not retrospective, it was immediately decl ared by the Apex Court in the subsequent decision in Commissioner of Income Tax v. Kanji Shivji And Co. (242 ITR 124) that those

observations in Rashiklal case, cited supra, regarding the amendment not being retrospective were obiter and, therefore, the legal position that emerges is that the aforementioned provision under Explanation 2 to (clause (b) of Sec.40 is also retrospective. From all this, the learned senior counsel urges that what is obtained in case of ôinterest paymentö has also to be applied in respect of the ôsalary paymentsö to the partners. In this case, according to the learned senior counsel, the amounts pertained to the year 1983-84 and if the interest payment was not made disallowable then, same logic must apply to the salary payments.

5. The learned senior counsel then took us to the section as it stands and pointed out that even the salary paid to a partner has been held not to be hit by Sec.40(b). For this proposition, the learned counsel relies on two decisions of the Andhra Pradesh High Court, they being N.T.R. Estate case, cited supra and Ramakrishnaiah B. Narayana & Co. v. CIT (209 ITR 156). The learned counsel urges that even without relying upon the present form of the section, the Andhra Pradesh High Court has held categorically in these two decisions that what applies to the interest payable to the partners also applies to the salary payable to the partners where such a partner is a partner on behalf of a Hindu Undivided Family.

6. In the case of N.T.R. Estate case, cited supra, the Division Bench was concerned with the explanations to Sec.40(b) and was considering the question of disallowance of interest as well as the salary paid to the partners. After discussing the caseload, the Division Bench came to the conclusion that the effect of the explanations was:

(a) if a person is a partner in a firm in a representative capacity and if such partner lends to the partnership Moines belonging to him individually, then the interest paid to such partner on the monies lent by him is not liable to be added back under section 40(b) of the Act; and

(b) similarly, if a person is a partner in his individual capacity and if such partner lends to the partnership monies belonging to the Hindu joint family of which he is the ôkartaö, then the interest paid on the monies lent by the joint family is not liable to be added back under section 40(b) of the Act.

Ultimately, a finding was recorded that the interest paid by the assessee firm to its partners on the monies lent by them in their individual capacity is not liable to be disallowed under Sec.40(b) inasmuch as the partners were acting in a representative capacity so far as the partnership interest is concerned. It is then the following observations appeared in the judgment:

ôIn our opinion, the same principles as are mentioned above in connection with the payment of interest by a partnership firm to its partners are also applicable in regard to the payment of salary to a partner. In order to determine whether the salary paid to a partner should be allowed as a deduction in computing the income of the partnership firm, it is necessary to examine who is the real recipient of the salary paid to the partner.ö

Thereafter referring to the judgment of the Madras High Court in Somasundara Nadar Sons v. CIT (137 ITR 815), the Division Bench observed:

ôThe principle enunciated by the Madras High Court is that the allowance or otherwise of interest shall have to be determined with reference to the real recipient of the interest and not merely with reference to the person formally receiving the interest. We are in entire agreement with this view. The principle of æreal recipientÆ is as much applicable to salary as it is to interest. In some cases, salary may be paid to a partner under the agreed terms and conditions between the partners for services rendered by the partner individually in connection with the business carried on by the partnership; in some cases, the payment of salary may have connection with the investment of capital by the Hindu joint family whom the partner is representing in the partnership. In a case, where a paerson is a partner in his individual capacity and salary is paid to him for services rendered by him individually in connection with the business carried on by the partnership, there can be little dispute that such salary paid to the partner falls to be disallowed under section 40(b) of the Act. If it is, however, found that the person concerned is not a partner in the partnership firm in his individual capacity but is a partner in a representative capacity (representing for instance the joint family of which he is either the karta or a member) and the payment of salary has no real and sufficient connection with the share held by the joint family through the partner concerned, then the salary paid to the partner for his individual services cannot be disallowed in the computation of the income of the partnership firm. If, however, the real recipient of the salary is the joint family, although it was paid ostensibly to the partner, then the salary paid falls to be disallowed under section 40(b) of the Act. If it is established that the salary or remuneration received by the karta of a joint family from a firm in which he is a partner in a representative capacity was for services rendered by him individually and that there was no real and sufficient connection between the investment of the joint family assets in the firm and the salary or remuneration received by the karta could not be treated as income of the family. It has to be treated as his individual income and assessed as such. … In the present case, it is admitted that

salary was paid to two of the partners of the assessee-firm for services rendered by them individually, although they were partners in a representative capacity as kartas of their respective joint families. It is further admitted that the salary paid to the two partners was assessed in their individual hands, obviously accepting that there was no real and sufficient connection between the partnership interest held by the joint family through the karta and the salary or remuneration paid to the partner. In such circumstances, the same principles as are applicable in the matter of disallowance of interest which we have set out above are applicable in the matter of disallowance of salary or remuneration paid to a partner. ...ö(emphasis supplied)

7. The learned counsel also brought to our notice the subsequent decision of the Andhra Pradesh High Court in Ramakrishnaiah B. Narayana and Co., cited supra. This is also a decision by the Division Bench whereby the aforementioned decision in N.T.R. Estate case was referred. However, the argument therein was that the decision in N.T.R. Case require reconsideration in view of the Supreme Court decision in CIT v. R.M. Chidambaram Pillai (106 ITR 292). In that case, the Apex Court had held that salary paid to a partner is nothing but a share of profit and the explanation added to Sec.40(b) recognising the representative capacity of a partner referred only to the payment of interest and that could not be applied to the payment of salary. The Division Bench then went on to note that after the decision of the Supreme Court in CIT v. BAGYALAKSHMI AND CO. (55 ITR 660), where the Apex Court had held that a Hindu Undivided Family cannot be a partner in a firm and it is only the individuals who can form a partnership and that representative capacity of the individuals forming the partnership would be no relevance to the other partners, certain hardships had arisen in cases where an individual was a partner of the firm and the joint family advanced money to the firm and such interest paid to the joint family was being added back to the profit of the firm. The Division Bench, however, observed that recognising this hardship the section was amended and the explanations to Sec.40(b) recognising the representative capacity of a partner in case of payment of interest was acknowledged. The Division Bench observed that there could not be partial recognition of such representative capacity and once it was recognised that the real partner was the joint family, it would follow that payment of salary could be regarded as a share of the profit only if the salary was paid to the joint family itself and assessed in its hands in the status of a joint family. The Division Bench also relied upon the provisions of the Hindu Gains of Learning Act, Act 30 of 1930 and observed:

ôOnce the joint family is recognised as a the real partner of the firm, the law has departed from the original

position of recognising only the individual as a partner and, consequently it must also be recognised that the salary paid to the individual not being part of the income of the firm, cannot be taken as part of the share of profit of a partner. In the circumstances, when section 40(b) refers to the salary paid to a partner, it cannot take into account the salary paid to the individual as a representative of the joint family as he is not a partner in his individual capacity.ö

The Division Bench, thus, confirmed the law laid down by the Andhra Pradesh High Court in N.T.R. Estate case, cited supra.

8. Both these decisions, however, came much prior to the decisions of the Supreme Court in Brij Mohan case and Suwalal case, cited supra, and for that matter even Rashiklal case, cited supra. As such, the Andhra Pradesh High Court did not have the advantage of the aforementioned decisions of the Supreme Court.

9. The learned Departmental Counsel very heavily relied on RashiklalÆs case, cited supra, and pointed out that in Rashiklal case, the Supreme Court has explained and reiterated the position of a Hindu Undivided Family is-a-is a partnership firm and has in very certain terms held that a Hindu Undivided Family directly or indirectly cannot become a partner of a partnership firm because the firm is an association of individuals alone. The learned Judges of the Apex Court also clarified that all the provisions relating to the mutual rights and liabilities are only applicable to the individual partners who are members of the firm and there was no way that a Hindu Undivided Family could intrude into the relationship created by a contract between certain individuals. The only right of the Hindu Undivided Family was possible to call upon its nominee partner to render accounts for profits that he had made from the partnership business but that would be something between the nominee and Hindu Undivided Family and the partnership firm would not be concerned with what goes on between the nominee and the Hindu Undivided Family. The learned Judges also referred to Sec.13 of the Partnership Act, 1932 and observed that under that provision a partner was not entitled to receive any remuneration for taking part in the conduct of the business and every partner was bound to attend diligently to the business and for doing his duties, he cannot charge his CO-partners any sum or remuneration, whether in the shape of salary, commission or otherwise, on account of the trouble taken by him in conducting the partnership business. The learned Judges, however, observed that there could be a special contract to the contrary in which case, the provisions of that contract would prevail. The learned Judges, therefore, came to the conclusion that Sec.40(b) of the Act would

apply even where there is such a special contract and any commission paid by a firm to its partners will not be permitted as deduction as business income of the firm. If a claim was made by a nominee representing a Hindu Undivided Firm or any body of persons then the position of law would not be differ ent. The learned Judges again reiterated:

ôThe Hindu undivided family is not and cannot be a partner in a partnership firm. The remuneration or the commission that is paid to the partner cannot be claimed to be a remuneration or commission paid to the Hindu undivided family. The partner may be accountable to the family for the monies received by him from the partnership. But, in the assessment of the firm, the partner cannot be heard to say that he has not received the commission as a partner of the firm, but in a different capacity. ... A partner does not act in a representative capacity in the partnership. He functions in his personal capacity like any other partner. The provisions of the Partnership Act and the Income-tax Act relating to partners and partnership firms will apply in full force in respect of such a partner. If any remuneration is paid or a commission is given to a partner by a partnership firm, section 40(b) will apply even if the partner has joined the firm as a nominee of a Hindu undivided family. The Hindu undivided family or its representative, does not have any special status in the Partnership Act. ... The assessment of a firm will have to be made strictly in accordance with the provisions of the Income-tax Act. The law has to be taken as it is, Section 40(b) applies to certain payments made by a firm to its partners. Neither the firm nor its partners can evade the tax law on the pretext that although in law he is a partner, in reality he is not so. He may have to hand over the money to somebody else. That may be his position qua a third party. But the firm has nothing to do with it. It has paid the commission to one of its partners. It cannot get any deduction in its assessment for that payment, because section 40(b) of the Act expressly prohibits such deduction.ö

This was a case where the Supreme Court was considering the question of commission paid to a partner Rashiklal which payment was claimed as a deduction. The Supreme Court relied on the decision in Dulichand Laxminarayan v. CIT (29 ITR 535) to hold that a firm was not a æ personÆ and as such it was not entitled to enter into a partnership with another person or an individual. After referring to the definitions of æPartnership firmÆ, æPartnerÆ and æFirm nameÆ and after quoting the excerpts of the judgment in Dulichand case, cited supra, the Supreme Court observed:

ôthat the Hindu undivided family cannot be in a better position than a firm in the scheme of the Partnership Act. The reasons that led this court to hold that a firm cannot join a

partnership with another æ individualÆ will apply with equal force to a Hindu undivided family. In law, a Hindu undivided family can never be a partner of a partnership firm. In law, a Hindu undivided family can never be a partner of a partnership firm. Even if a person nominated by the Hindu undivided family joins a partnership, the partnership will be between the nominated person and the other partners of the firm.ö

The Court then took the stock of the judgements in Brij Mohan case and Suwalal case, cited supra, as those cases were referred to suggest therein that interest paid to a partner in his representative capacity was outside the purview of Sec.40(b) of the Act because of the explanation. The Court specifically pointed out on this as follows:

ôHowever, in the case before us, no question of payment of any interest is involved. A commission was paid by the firm for the services rendered by the partner. Such commission cannot be paid because of the provisions of section 13 of the Partnership Act in the absence of a special contract. Even if a special contract exists, section 40(b) of the Income-tax Act prohibits allowance of such commission as deduction from the business income of the firm.ö

Thus, in so far as the argument of representative capacity was concerned, the Supreme Court restricted that representative capacity only to the interest as per the express language of the explanation to Sec.40(b). At more than one places, the Apex Court has specified that the position of payment of interest may be different because of the explanation but that cannot apply to a commission or remuneration paid by the firm to the partners. Thus, it is obvious that in Rashiklal case, cited supra, the Supreme Court rejected the claim for the deduction of the commission paid to the partner on two counts, viz.:

(i) That the said payment could not be deducted merely because the partner represented a joint Hindu family and the payment would have to be viewed as payment to the partner himself;

(ii) The explanation covered only interest and that the commission or the remuneration could not be read on par with interest which could not be disallowed by reason of explanation (2).

10. The learned senior counsel tried to get out of this position by suggesting that the observations in Rashiklal case, cited supra, were treated to be obiter in a subsequent decision in Kanji Shivji and Co. Case, cited supra. We must point out that what was held to be obiter was not the whole law laid down

in Rashiklal case, cited supra, but only the aspect of retrospectively of the explanation (2) to Sec.4 0(b). The Court clearly observed as:

ôThe observations in Rashiklal case relating to the said explanation must therefore be treated as obiter dictaö.

The Court also reiterated that the law laid down in Brij Mohan case and Suwalal case, cited supra, continue to be the correct law. The only concerned issue was relating to the prospectively or retrospectively of explanation (2) to Sec.40(b) and only the view regarding the retrospectively alone which was contrary to the earlier decided case which were held to be obiter. Therefore, the observation in Rashiklal case, cited supra, regarding remuneration or commission paid to a partner by a firm being covered by Sec.40(b) was never doubted nor were held to be obiter in the subsequent Supreme Court decision of Kanji Shivji case, cited supra. Thus the law appears to be clear that where there was a payment made in the nature of salary, it could not be covered by Explanation 2 to Sec.40(b). This precise view was followed by the Gujarat High Court in National Wire Manufacturing Co. v. CIT (171 CTR 376).

11. The Gujarat High Court, in National Wire Manufacturing Company case, after taking the stock of the Supreme Court decisions in Brij Mohan case and Suwalal case, cited supra noted the established law regarding the interest paid to the partner by the firm to be covered under Sec.40(b) and, therefore, not deductible. The Gujarat High Court also referred to its earlier judgment in Yoganand Textiles case (202 ITR 869) wherein Sec.40(b) was interpreted to mean that any payment to the nature described made by the firm to any of the partners of the firm would not be deductible. The Gujarat High Court also took note of the stress given in the aforementioned judgment on the word ôanyö and concurred that the word being of wide import has to be given its full meaning in the context of the provision. The Bench also agreed and confirmed the view that there is no indication whatsoever to differentiate between the nature of remuneration or between the purpose for which remuneration was given to any partner and held that the provision imposed an absolute embargo against the deduction in respect of any of the payments made by the firm of the nature enumerated to any of the partner of the firm in the earlier judgment. Regarding Explanation 2 it was held that it was added to clarify that interest paid by the firm to an individual who is a partner in a firm in a representative capacity shall not be taken into account for the purpose of the said clause. The Division Bench also endorsed the view that there was nothing in the said provision to indicate that any category of salary, remuneration, etc. though paid by a firm to a person who is a partner were to fall outside the scope of Sec.40(b). The Bench also took stock of the

dictionary meaning of the words æsalaryÆ, æ commissionÆ and æremunerationÆ and pointed out that the three terms carry the same basic meaning, i.e. to compensate for services rendered. The High Court, therefore, posed a question as to what would be the difference in between the payment of interest and the commission, remuneration, salary, etc. paid for the services rendered by the partner. The High Court then reiterated the earlier view expressed by the Supreme Court in RM Chidambaram Pillai case, cited supra, and also then referred to Rashiklal case, cited supra and noted the law laid down therein that if a firm cannot join with another on similar lines a Hindu undivided family also cannot join the partnership with another individual and that the Hindu undivided family being a fluctuating body of individuals cannot join a partnership with other individuals and if Karta of any other member of a Hindu undivided family joins a partnership firm he does it only as an individual and his rights and obligations would be determined by the Partnership Act and not by the Hindu law. The judgment then quotes the passage from the Rashiklal case, cited supra, and notes the law laid down therein that the remuneration or commission that is paid to the partner cannot be claimed to be a remuneration or commission paid to the Hindu Undivided Family. The Bench then holds:

ôInsofar as the interest is concerned the same would stand on a different footing in view of the fact that it is possible to trace the source of the funds. Therefore, the aspect of a partner having dual capacity, i.e. one as a partner in a partnership firm and the other qua the interest of the person who is represented by such partner is recognised because the question that could be posed and answered : interest is paid on which funds and who has invested those funds?ö

The Court then referred to its Full Bench decision Chhotalal & Co. v. CIT (150 ITR 276)and also noted the observations made by P.S. Poti, C.J. Wherein the salary payment was treated on a different footing than the other payments. Though even there, the question of the finality of the law as decided by Rashiklal case, cited supra, was questioned, the Gujarat High Court answered the question that the observations in that case were held to be obiter in Kanji Shivji case, cites supra, on an entirely different issue which was stated specifically in Kanji Shivji case and which pertained only to the question of retrospectivity. It noted that the Apex Court itself was aware that the payment of salary, commission or remuneration should stand on the different footing. Ultimately, the Court came to the conclusion that there was no conflict between the position relating to payment of interest on the one hand and positions dealing with the payment of salary, commission, remuneration on the other hand. In short, the Gujarat High Court completely accepted the stand that the payment of salary could not be equated with the payment of commission.

12. We see no reason to take a different view. In fact, if Explanation 2 to Sec.40(b) spoke only of the interest paid to the partners by the firm providing an escape route for such payments from the rigour of Sec.40(b) an interpretation cannot be handed out enlarging the scope and reading into the explanation additional words like æsalaryÆ, æcommissionÆ, æremunerationÆ, etc. At least when the explanation was introduced, the legislative intent was only to provide for such an escape to the interest paid and it clearly excluded from the explanation, the salary, commission, remuneration, etc. paid by the firm to the partners. Therefore, the word æinterestÆ cannot be interpreted to mean any other payments like salary, remuneration, commission, etc. which, though are to be found to be in the main provision of Sec.40(b), are not to be found in Explanation 2. As held in Rashiklal case, cited supra, the assessment of a firm has to be made strictly in accordance with the provisions of the Income-tax Act. The law has to be taken as it is. In that case, the Apex Court refused to equate the æ interestÆ with the æcommissionÆ paid by the firm for the services rendered by the partners on the ground that under Sec.13 of the Partnership Act, in the absence of a special contract, commission would not have been payable and that even such a special contract existed, Sec.4 0(b) prohibited treating of such commission as deduction from the business income of the firm.

13. Further, the argument that since Rashiklal had joined the firm not as an individual but in a representative capacity and, therefore, the amounts paid to him could not be covered under Sec.40(b) was repelled by holding that the partnership firm was a compendious way to describe the individuals who are partners of the firm and other partners of the firm could have the contractual relationship with Rashiklal only and if Sec.40(b) categorically disallowed any deduction of payment of commission to a partner, there would be no question of allowing such payment to be deducted. The Court observed:

ôTherefore, there is no scope for any argument that even though under the Indian Partnership Act, a Hindu Undivided Family not being a æ personÆ cannot be a partner, the payment of commission to the nominee partner will be tantamount to payment to HUF and, therefore, such payment will not come within the mischief of the Partnership Act or Sec.4 0(b) of the Income-tax Act.ö

The Apex Court has considered the whole gamut of a partnerÆs liability vis-a-vis the other partners as also his position vis-a-vis the Hindu undivided family which he represents. The Apex Court then very specifically held:

ôIf any remuneration is paid or a commission is given to a partner by a partnership firm, Sec.40(b) will apply even if the

partner has joined the firm as a nominee of the Hindu undivided family. The Hindu undivided family or its representative does not have any special status in the Partnership Act. Although the partnership firm is not a legal entity, it has been treated as an independent unit of assessment under the Income-tax Act. The assessment of a firm will have to be made strictly in accordance with the provisions of the Income-tax Act. The law has to be taken as it is.ö

All this will go to show that there is no scope for salary paid to a partner by the firm being excluded from the operation of Sec.40(b) of the Income-tax Act.

14. The learned counsel lastly argued, almost by way of a desperate argument, that the amendment made by Finance Act 1992 with effect from 1-4-1993, provides the remuneration paid to the partner, if the terms of the partnership deed provides for the same, is outside the purview of Sec.40(b). The relevant provisions are as under:

ô40. Notwithstanding anything to the contrary in sections 30 to 38, the following amounts shall not be deducted in computing the income chargeable under the head æProfits and gains of business or professionÆ,-

(a) not relevant

(b) in the case of any firm assessable as such,-

(i) not relevant

(ii) any payment of remuneration to any partner who is a working partner, or of interest to any partner, which, in either case, is not in accordance with, the terms of the partnership deed; or

(iii) any payment of remuneration to any partner who is a working partner, or of interest to any partner, which, in either case,is authorised by, and is in accordance with, the terms of the partnership deed, but which relates to any period (falling prior to the date of such partnership deed) for which such payment was not authorised by, or is not in accordance with, any earlier partnership deed, so, however, that the period of

authorisation for such payment by any earlier partnership deed does not cover any period prior to the date of such earlier partnership deed; or

(iv) not relevant

(v) any payment of remuneration to any partner who is a

working partner, which is authorised by, and is in accordance with, the terms of the partnership deed and relates to any period falling after the date of such partnership deed in so far as the amount of such payment to all the partners during the previous exceeds the aggregate amount computed as hereunder:
... ...ö

From this the learned counsel says that the legislature though had directed the disallowance of such remuneration in the unamended provision of Sec.40(b), such remuneration will not now be hit by Sec.40(b) so as to be disallowed under that section. The argument is such remuneration or salary paid to the working partner has been brought on par with the interest paid by the firm to the partner for which an escape route was provided vide Explanation 2. The argument goes further to say that therefore, even in respect of the earlier period, we must interpret Explanation 2 so as to include the salary or as the case may be the remuneration paid to the partner along with the interest paid by the firm to the partner. The argument is clearly misconceived.

15. The learned counsel very fairly and candidly submitted that it was not his case that the amendment made in 1992 which had the effect of allowing the salary paid to the working partner in terms of the partnership deed being a allowable expenditure was retrospective in nature. The only argument is that since the legislature has now treated such salary on par with and identically as the interest paid by the firm to the partner, we should hold that the remuneration or salary in this case for the assessment year 1982-83 is not hit by Sec.40(b).

16. The argument is totally incorrect. In the first place, the interpretation of Explanation 2 with effect from 1-4-1985 was held to be retrospective on the ground that such explanation was of declaratory nature. In Brij Mohan case and Suwalal case, cited supra and though itÆs retropestive nature was doubted in Rashiklal case, cited supra, the Supreme Court, in Kanji Shivji case, cited supra, clarified the situation to the extent that the observations in Rashiklal case, cited supra, were obiter. Here the learned counsel himself is conceding that it is not his case that the present amendment made in the year 1992 are of retrospective nature. Therefore, there will be no question of making applicable these amendments to the case in hand which pertains to the assessment year 1982-83. Once that situation is obtained, there would be no scope to hold that the the legislature intended to include even the remuneration and the salary on par with the interest paid to the partner by the firm so as to be out of the mischief of Sec.40(b). The law has to be read as it is and merely because subsequently the law underwent

change in respect of the remuneration to the partner, it cannot be treated that the legislature always had the intention to take out the remuneration of the mischief of Sec.40(b). In fact, Rashiklal case, cited supra, is a complete answer that the commission also was completely covered by Sec.40(b) as it stood then. We do not see any merit in this contention and reject the same.

17. We, accordingly, answer the reference against the assessee and in favour of the Department holding that the concerned authorities were right in treating the payment of salary to the partners by the firm as hit by Sec.40(b) of the Act and disallowing those business expenditure.

18. In T.C. No.165 of 1989, the question regarding the assessment year 1982-83 is identical in nature except for the difference in the amount claimed on account of payment of salary. Needless to say that this case will be governed in the same manner as has been done in this judgment. We, accordingly, answer this reference also against the assessee and in favour of the Department.

Index:
yes/No
(V.S.S.,J.) (K.R.P.,J.)
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